

May 1, 2006

HONORABLE MAYOR AND CITY COUNCIL:

As this 2006-2007 Proposed Operating Budget is being prepared, the City of San José finds itself at a critical juncture. We continue to confront the need for significant budget reductions. In fact, this year represents the fifth consecutive year in which the Proposed Budget contains multi-million dollar reduction proposals in the City's General Fund, and the forecast is for continued shortfalls over the next five years. This year is different from previous years, however, in that there are now solid indications that a steady if slow recovery is finally underway in the local economy. Despite this modest turnaround, however, it is also critical to note that for this year and the foreseeable future projected growth in revenues will not be sufficient to meet expenditure obligations, both for existing programs and for new operating and maintenance costs that accompany our *Decade of Investment* capital improvement program. As would be true at the start of any period of economic recovery, but particularly in light of our structural deficit situation, it is now more critical than ever that we resist the temptation to add resources beyond those that our existing revenues will support. A careful reading of this proposed budget document will reveal the strategic addition of resources to address critical service and infrastructure needs. However, it will also reveal that we have only avoided more significant and severe budget cuts through the proposed extension of the Emergency Communication System Support Fee, which provides approximately \$20.6 million annually to the Operating Budget.

As we enter this fifth year of budget deficits, it remains an extraordinary accomplishment that to date the organization has avoided more serious reductions. Nevertheless, the reductions we have experienced since 2001, which total more than \$260 million, have not come without a cost. Critical infrastructure needs have been postponed, and while the workforce has shrunk by 782 positions, few programs have been eliminated, requiring the existing workforce to do more with less. This approach simply cannot be sustained without serious consequences. Infrastructure maintenance needs that are left unattended will lead to far more expensive repairs down the road. A workforce asked to do too much with too little will make mistakes, and employees will seek better work environment elsewhere. These are unacceptable propositions, and the City Council will find recommendations in this Proposed Budget for cautious investment in both infrastructure and personnel.

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As a result, this Proposed Budget reveals the odd juxtaposition of two apparently conflicting messages. On the one hand, we continue to face significant funding shortfalls for the foreseeable future, and while revenues are growing modestly, the pace of this growth is simply not enough to keep up with the expenditures that are necessary to meet existing obligations. On the other hand, due to conservative budgeting practices and a modestly improved economic picture, we are in a position to utilize one-time revenue overages and expenditure savings from the current year to strategically add resources to begin addressing critical current and future needs.

The recommendations in this budget are based on the underlying assumption that the economic environment in the region will neither return to the extremely high growth levels experienced in the late 1990s nor drop back into the recession conditions that so devastated City finances in the first four years of the new decade. While the Valley economy and the associated City revenue performance are expected to resume modest growth, as noted earlier, expenditure levels of existing General Fund programs are expected to exceed those revenue growth rates.

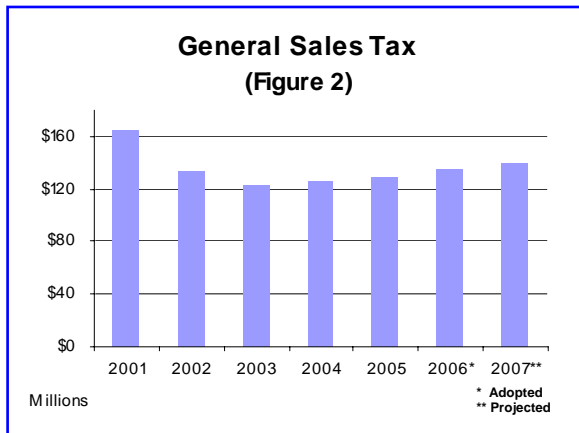
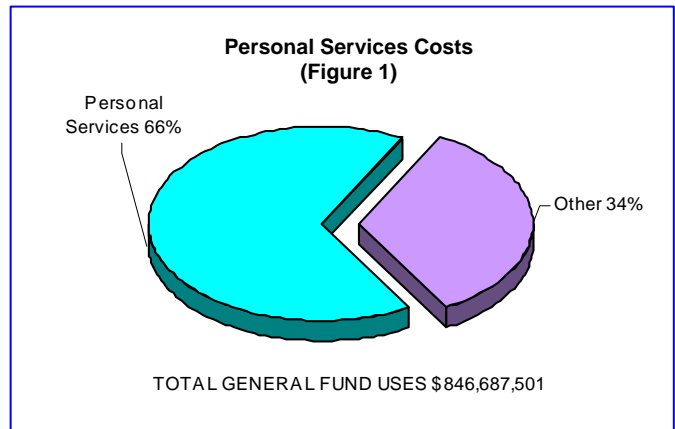
Despite the ongoing fiscal challenges, the recommendations in this Proposed Operating Budget continue to focus on City Council priorities, directing resources toward essential services, basic infrastructure requirements, economic development opportunities, and maintaining the City's strong commitment to neighborhoods. As a result of the improving economic picture and in recognition of the City Council's long commitment to supporting our community partners, the recommendations in this Proposed Budget would not reduce funding to Community-Based Organizations (CBOs) equal to the average of the non-Public Safety reductions as has been the case for the last several years. Instead City Service Areas (CSAs) continue to focus resources on core functions and proposed reductions have been minimized through the strategic use of one-time dollars. For the fourth time in as many years, proposed reductions are divided between Tier One, consisting of recommendations to be implemented immediately, and Tier Two proposals that, in this case, would be implemented only if the Emergency Communication System Support (ECSS) Fee is not extended beyond the current 2006 sunset date. The reductions contained in the *2006-2007 Emergency Communication System Support Fee Contingency Plan* can be found in a separate section toward the back of this document.

Our ability to sustain services through the long recession has rested on the conservative fiscal policies adhered to by the City Council and the organization over the past four years—a commitment we must maintain again this year. As we have in years past, this year we imposed a Cost/Position Management Plan to reduce the impact of the anticipated General Fund shortfall by requiring every General Fund department to meet a savings target in the current fiscal year. This effort resulted in additional savings of \$6 million to help balance the 2006-2007 Operating Budget. We also continued the freeze in hiring for non-critical positions, first imposed in 2001, with the desired effect of reducing expenditures and preserving vacancies to avoid lay-offs as services are reduced or eliminated. While these strategies will be familiar to anyone who has followed the City's budgeting efforts since 2001, another trend of the past four years is reversed in this proposal with the recommendation of a modest increase in our overall employee count. Since 2001, the number of City employees has steadily decreased from a high of nearly 7,500 employees, to 6,672 in the current budget year, roughly the same number of employees as in 1999. With the 2006-2007 Proposed Budget, the number of positions would increase by 131 to 6,803. The majority of new

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positions, 83 in all, are being driven by staffing requirements in bond-funded facilities that will be brought on-line in 2006-2007.

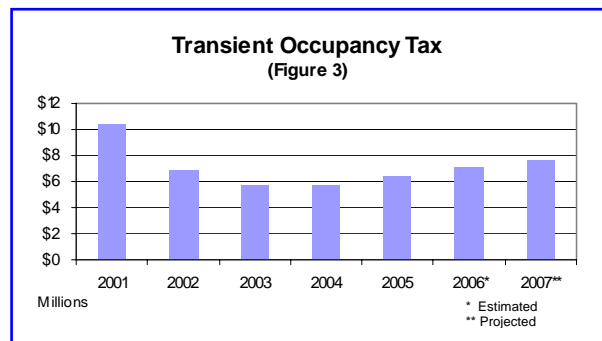
While the ability to add some staff is a welcome change, as discussed above, the City continues to confront a structural problem in the General Fund with expenditures exceeding revenues in each year of the 5-Year Forecast. While nearly all City employees partnered with the City in holding salaries down at the worst of the recession, upward pressure has now resumed, and the City cannot expect to attract and retain employees if salaries lag behind those of surrounding agencies. As shown in the Personal Services Costs chart (Figure 1), two-thirds of the General Fund costs are directly tied to personnel costs.



All of the expenditure management actions implemented in past years have been continued through the 2005-2006 Fiscal Year. In addition to the Hiring Freeze and Cost/Position Management plans cited above, we have continued expenditure controls on technology, marketing, travel and vehicle purchases first imposed in 2003, and have continued to offer a Voluntary Furlough and Special Reduced Work Week program, which this year saved \$1.1 million. Total General Fund revenue projections (excluding fund balance) in the 2005–2006 Adopted Operating Budget were

\$682.8 million and for 2006–2007 current projections place the base budget revenues number at \$711.9 million a 4.3% increase. While a full review of the City's current and projected fiscal picture is detailed in the *General Fund Balancing Strategy Detail* (Attachment A), some noteworthy trends are highlighted here. Sales tax revenue (Figure 2) is showing moderate growth of 6.5%, and the Transient Occupancy Tax (Figure 3), which is tied to revenue from local hotel bookings is projected to grow by nearly 18% (however, growth of only 7% from the 2005-2006 year-end estimate is anticipated). Property tax revenues also remain extremely strong, showing growth of almost 28%.

The size of the Property Tax growth is somewhat misleading, however, because it includes the return to the General Fund of an \$11.1 million revenue stream that for two years was diverted to State coffers and the one-time impact of the VLF Swap true-up. Without this change Property Tax revenues are projected to grow by approximately 12.5%. Unfortunately, as a consequence of the



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softening real estate market, the forecast for future Property Tax revenue is for significantly lower growth.

In recent years San José has been very prudent in its use of reserve funds, and it is important to note that this cautious approach is one of the key factors that has allowed San José to sustain a strong AA+ bond rating. This rating is still the highest of any major California city and has translated directly to the City's bottom line by keeping interest rates low when we borrow money.

With the slow emergence from the deficit now clearly underway, it would be tempting to loosen the tight fiscal discipline that has guided our budget efforts through the downturn. Until we see economic growth sustained for a couple of years, however, we should continue to act prudently and dedicate one-time dollars to meeting two critical needs: 1) infrastructure maintenance costs that have grown significantly over the past five years; and, 2) emergency reserves in the event of another slow-down triggered by rising costs for fuel, as well as personnel costs such as health and retirement. The City Council will find recommendations for the use of one-time dollars to replenish our Economic Uncertainty Reserve through the addition of \$4 million in one-time current year fund balance funds, and the creation of a \$5.3 million *Transportation Infrastructure Maintenance Backlog Reserve* from the same source. While the creation of such a transportation infrastructure reserve represents a good first step, this amount pales in comparison to the outstanding needs for pavement repair and other transportation infrastructure improvements that have been identified. Readers will also find smaller reserves established to begin addressing unmet technology needs (\$3.5 million) as well as facility infrastructure maintenance (\$1.0 million).

ECONOMIC OVERVIEW

As is the case every year, the most significant challenge the Administration faces in formulating a budget for the coming year is projecting the condition of the local economy and the associated level of revenue collections. Monitoring of revenue collections through the first eight months of the year have confirmed the general accuracy of the key assumptions used to build the *2005-2006 Adopted Budget*: 1) that the severe downturn experienced over the last four years has bottomed out; 2) that the local economy has begun to experience modest economic growth; and 3) that there is little chance for a resumption of the levels of growth experienced just prior to the crash of 2001-2002. As a result, by taking a conservative approach in our budget projections, the current year General Fund revenue collections, particularly in our economically sensitive categories, are generally running at or above budgeted levels.

Revenue estimates for 2006-2007 have been built on two overriding basic assumptions: 1) that the economy at the national, state and local level will continue to exhibit growth, but that growth will be down slightly from that experienced this year; and, 2) that we will continue to experience approximately the same current modest growth levels in our local revenues for the next full fiscal year.

The first assumption reflects the consensus of most forecasters as they look at the **National** and **State** economies. Predictions are for continued growth but at a reduced level due to three factors: 1) spiking oil prices; 2) a slowing housing market; and, 3) the continuing rise in interest rates engineered by the Federal Reserve Board. Consumer spending is 70% of the national economy.

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ECONOMIC OVERVIEW (CONT'D.)

The single biggest reason the last recession wasn't worse, was the willingness of consumers to continue to spend in spite of the tough economic conditions. We share the belief of most economists that the state of consumer confidence and associated spending rates will be negatively impacted to some extent next year, the result of both rising energy costs that are taking increasing amounts of dollars out of consumer's pockets, and the cooling housing market. One economic expert, Joseph Stiglitz, professor at Columbia University and winner of the 2001 Nobel Prize in economics, describes well the expected impact of the housing market downturn: "We've been sustaining consumption by taking money out of housing. As the housing market slows, we will not be able to maintain the increases in consumption that we need to sustain growth at 3 or 4% a year."

A more significant concern, particularly for California and the Bay Area is the risk of a fall in housing prices that is more precipitous than the current relatively moderate rate of decline. There is a fear among an increasing number of economists, that five straight years of record home sales, fueled by the lowest mortgage rates in recent history, spurred a speculative fever in housing similar to the forces that created a bubble in stock prices in the late 1990's. These economists see a crash in home prices as one of the biggest threats to economic growth, and the areas at greatest risk are areas such as California, Nevada, and Arizona which have the hottest home sales markets. We will continue to monitor this closely.

As to expectations for the **Local** Bay Area and Silicon Valley economy, it is encouraging that the significant drop in revenue suffered over the prior four years has now stabilized, and modest growth in our economically sensitive revenues has resumed. Although the growth rates now being experienced appear sustainable, subject to the risks described above, we still find no substantive reasons to believe that the levels of growth will exceed the current modest levels for the near term.

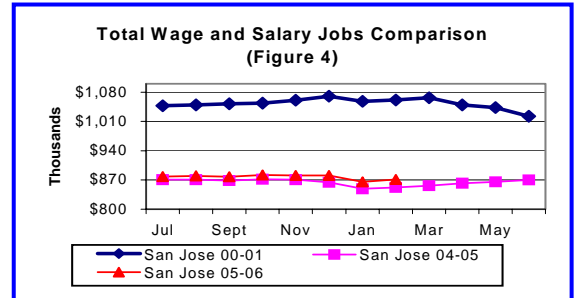
Among our two largest General Fund revenue sources, Property Taxes have exceeded expectations, not only this year, but for the past several years, due to the fact that the local real estate market has sustained levels of growth higher and for longer than expected. Since Property Taxes for 2006-2007 will be based on the calendar year 2005 tax rolls, the City is likely to see at least one more year of solid growth in this area even as local housing growth slows. Our revenue estimates for the 2006-2007 Proposed Budget in this category reflect that expectation. Following four years of poor performance, the most economically sensitive revenue we rely on, General Sales Tax, is now also experiencing steady growth. That growth, has however, been much more unpredictable, with strong quarterly growth reports being followed by quarters where growth was virtually nonexistent. In the most recent two quarters, for example, growth of 14.5% in the first quarter of the year was followed by a second quarter where growth of just 2.3% was experienced. Our expectations for next year are for modest growth in this our second largest General Fund revenue source, with a proposed growth rate of 3% over the 2005-2006 estimated level.

Since the beginning of the economic downturn, however, it has been our consistent belief that the most reliable predictor of local economic improvement is the local jobs picture. While the employment situation has stabilized and there are even some signs of small increases, we are still seeing no signs of a significant rebound. The very slight growth experienced over the last several months has recovered only a small fraction of the more than 200,000 jobs that were lost locally

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ECONOMIC OVERVIEW (CONT'D.)

during the recession. In fact, as far as the employment picture goes, we still seem to be living in a period of two separate economies, the National/State economy and the local economy, which are experiencing vastly different employment scenarios. Job growth nationwide and at the State level has resumed at relatively healthy levels over the past 12 months. More than two million jobs have been created at the national level, and over 190,000 jobs created in California. By comparison, local job growth continues to lag. March employment data, the most recent data available at the time this



document was formulated, confirms that situation as unchanged. The valley gained a miniscule 3,800 jobs between February 2006 and March 2006, after losing 13,600 jobs between December 2005 and January 2006. Although year-over-year employment for the period of March 2005 to March 2006 saw an increase in overall jobs, that increase was minimal -- just 6,800 or 0.8%. Absent clear signs of vigorous growth in this area, we continue to believe it is prudent to assume only modest growth levels in the local economy and in local revenues in the 2006-2007 Proposed Operating Budget.

BUDGET OVERVIEW

In the 2006–2007 Proposed Operating Budget, the total net proposed funding is \$2.59 billion for all City funds (General, Special, and Capital). This is \$74.0 million or 2.8% lower than the 2005–2006 Adopted Operating Budget (Table 1 below). As noted above, the total number of positions increased by approximately 2%, to a total of 6,803.

2006–2007 PROPOSED BUDGET — ALL FUNDS (Table 1)			
	2005–2006 Adopted	2006–2007 Proposed	% Change
General Fund	\$ 841,688,233	\$ 846,687,501	0.6%
Special Funds	\$ 1,228,838,694	\$ 1,318,024,624	7.3%
<Less: Operating Transfers>	(\$567,501,127)	(\$631,245,553)	11.2%
Net Operating Funds	\$ 1,503,025,800	\$ 1,533,466,572	2.0 %
Capital Funds	\$ 1,168,675,771	\$ 1,067,426,208	(8.7 %)
<Less: Capital Transfers>	(\$7,176,000)	(\$10,388,000)	44.8%
Net Capital Funds	\$ 1,161,499,771	\$ 1,057,038,208	(9.0%)
Net Total	\$ 2,664,525,571	\$ 2,590,504,780	(2.8%)

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BUDGET OVERVIEW (CONT'D.)

The General Fund portion of the City's Budget would decrease by 0.6% from 2005–2006, and totals \$ 846.7 million. As always in the Proposed Budget, this is a somewhat misleading figure. Because the proposed budget is prepared two months before the end of the fiscal year, the numbers above do not include the additional funds that will be re-budgeted to complete multi-year projects.

Budget Balancing Strategies

Our earliest projections for 2006-2007 predicted a \$76 million shortfall nearly half of which (\$31.2 million) resulted from the use of one-time dollars to balance the 2005-2006 Operating Budget. As we enter the fifth straight year of significant funding gaps, cost management controls that once seemed extraordinary are now integrated into the day-to-day operation of the City. In October, the City Council established a *2006-2007 Future Deficit Reserve* by setting aside \$12 million of year-end fund balances during the final reconciliation of the 2005-2006 Budget. The Cost/Position Management plan, that the Administration imposed in October yielded an additional \$6 million in savings for the fund and translated to a 1% reduction for Public Safety and a 2% reduction for all other CSAs. In February, the Five-Year Forecast showed an improved picture with the projected General Fund shortfall dropping by \$40 million. Two factors contributed to this drop. First, the actual cost of the Police/Fire Retirement Fund for 2006-2007 was \$25 million lower than the rate projected earlier by the Actuary. Second, an improving economy increased revenue projections by \$15 million. Further refinement of revenue and expenditure projections explained in detail later in this document resulted in a final General Fund shortfall in this Proposed Budget of \$35.9 million.

In developing the 2006-2007 Proposed Operating Budget, the Administration once again has focused City resources on vital core services and Council priorities. Each CSA including Public Safety was required to propose reductions and revenue enhancements. In Tier One, CSA reductions averaged 3.1% for the non-Public Safety CSAs. In recognition of the City Council's commitment to maintaining public safety as its top priority, the Public Safety CSA reductions were kept to 0.6%.

In preparing the 2006-2007 Proposed Operating Budget, the Administration was guided by a set of principles and strategies contained in the City Manager's Budget Request and adopted by the Council in the Mayor's Budget Message. This proposal also responds to the 113 directives contained in the Mayor's March Budget Message with descriptions of how the budget responds to these directives (Attachment B to this message). A total of 17 of these directives will be responded to through the Manager's Budget Addenda process.

The resulting 2006-2007 Proposed Operating Budget recommends some ongoing cost reductions, prudent fee increases, the extension of the critical ECSS Fee, the inclusion and conversion to ongoing of the Cardroom Business Tax revenue, and once again the strategic use of reserves and one-time revenues. The table on the following page shows the matrix of balancing strategies and the dollars associated with each action.

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BUDGET OVERVIEW (CONT'D.)

Tier One General Fund Budget Balancing Plan (Table 2)	
	In \$000s)
General Fund Shortfall	(34,890)
SOURCE OF FUNDS	
2006-2007 Future Deficit Reserve (one-time)	18,426
Emergency Communication System Support Fee ¹	10,357
Cardroom Revenue	9,500
Unrestricted Fund Balance	6,261
e-Government and Fee Program Earmarked Reserves	3,375
Transfers from Other Funds	3,224
Miscellaneous	3,908
Total Change in Source of Funds	55,051
USE OF FUNDS	
Staffing and Non-Personal/Equipment Reductions	(4,798)
Funding Shifts	(2,096)
Use of Reserves (Committed Additions)	(4,011)
New Facilities (Operations and Maintenance)	4,082
City Council Direction (Mayor's Message)	5,914
Technology and Capital Infrastructure Reserves	9,800
Economic Uncertainty Reserve	4,000
Miscellaneous Additions	7,270
Total Change in Use of Funds	20,161
Total Balancing Solutions	34,890

The improving economic picture has significantly reduced the need to eliminate positions as a part of the 2006-2007 balancing plan. While the ability to strategically restore some positions is good news, there are still real reductions and employee impacts in this proposal. As shown in the table below, recommendations in the Proposed Budget (Tier 1) would result in the elimination of 43 positions and the addition of 182 positions, for a net increase of 139 positions.

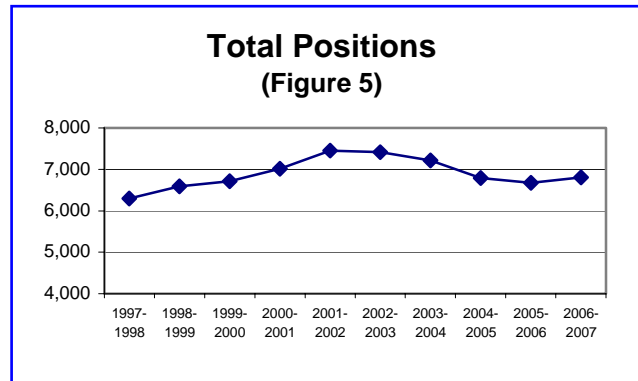
Changes in Position Count from Forecast to Proposed (Table 3)			
	Tier 1	Tier 2	Total
Reductions	(43.2)	(106.6)	(149.8)
Additions	181.8	0	181.8
Total	138.6	(106.6)	32.0

¹ ECSS Fee is scheduled to sunset on December 31, 2006. This proposal assumes the fee will be extended, adding half year revenue for 2006-2007 (\$10.4 million), and full annual revenue of \$20.6 million ongoing for future years.

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BUDGET OVERVIEW (CONT'D.)

Of the 43 positions recommended for elimination in the Proposed Budget, however, only one would need to be redeployed to another classification and we are confident that a position can be found for that employee. If Tier 2 actions are necessary, however, the number of position eliminations increases dramatically, with an additional 107 positions cut. As indicated earlier, the total number of positions would grow approximately 2% to 6,803 in 2006-2007. As Figure 5 demonstrates, even with the proposed additions, the total employee count is still only roughly equivalent to our 1999-2000 employee count. Since 2002 when the harshest impact of the economic downturn hit the City budget, the net reduction of City positions totals 650, a decline of almost 9%.



Similar to other recent budget proposal, the 2006-2007 Proposed Operating Budget is balanced with assumptions about things that have yet to occur, but which could have significant impacts on this proposal. Chief among these is the proposed extension of the Emergency Communication System Support Fee. Failure to approve this extension would create a \$10.4 million hole in the current budget proposal, and a \$20.6 million annual problem in the future. The Tier Two *Emergency Communication System Support Fee Contingency Plan* is not recommended for implementation at this time, but a review of this list reveals that virtually every CSA except Environment & Utilities would be impacted. Another problem would be unanticipated compensation increases resulting from the still unresolved bargaining unit agreements.

Fee & Rate Increases

The City's fee-based programs have real and direct benefits to the community. Fees paid by developers lead to better service levels, facilitating smoother transactions. Fees paid to support our Recycle Plus program have made San José a national leader in this area. The long-standing practice with fees has been that fee programs should be self-supporting to avoid a drain on the General Fund. For the past several years, however, we have avoided or minimized a number of fee adjustment to soften the impact on fee payers. As expenses continue to rise, however, an unavoidable consequence of postponing increases is that larger adjustments are required later. While it may be tempting to put off the difficult decision to raise fees, taking the long range view leads to the conclusion that more frequent but smaller increases in fees is a prudent approach.

As noted earlier, the recommendation to extend the Emergency Communication System Support Fee is a critical part of the balancing strategy contained in the 2006-2007 Proposed Operating Budget. While no increase is proposed in the Fee, it is recommended that Council extend the fee and re-establish its sunset date for June 30, 2015. In addition to being an integral part of the budget balancing strategy, this action would enable the City to add six new Public Safety Dispatcher positions needed to address a 13% increase in overall call volumes resulting from the transfer of

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BUDGET OVERVIEW (CONT'D.)

Fee & Rate Increases (Cont'd.)

responsibility for answering wireless 9-1-1 calls from the California Highway Patrol to the City's Communication Center.

In the Community and Economic Development CSA, a package of fee increases implemented between 2002-2003 and 2004-2005 greatly increased the financial stability of the development service partners in this CSA. For 2006-2007, however, Public Works, Building and Planning have projected cost recovery shortfalls ranging from 5.4% to 11.7% and the combined 2006-2007 base shortfall for the development service partners is approximately \$3 million.

To address these issues, discussions have been initiated with industry groups about desired service levels and the possibility of a four-year phased fee increase package based on a balanced fee program with clear cost/service impacts. While these discussions will continue through the budget process, this proposed budget includes fee increases of 7% for Building, Planning and Public Works, and a 4.5% increase for Fire. The development services package also includes the addition of two positions each for Fire, Public Works and Planning to address performance and an additional engineer for Building to improve consistency and customer service.

In the Environmental & Utility Services CSA, it remains a continuing strategic objective to achieve and maintain 100% cost recovery in the various special funds to ensure financial integrity and fiscal responsibility of funds.

The utility infrastructure in San José – the sanitary sewer system, storm sewer system, wastewater treatment plant, and water distribution system – is aging and requires increased maintenance. The problem is most critical at the Water Pollution Control Plant, where more than \$250 million in rehabilitation and replacement projects have been identified as necessary over the next 10 to 15 years. The City also is entering the final year of its NPDES (National Pollutant Discharge Elimination System) Storm Permit and beginning development of the permit for the next five-year cycle, which is expected to be a very complex and costly bay-wide regional permit. Finally, the City must comply with its NPDES Treatment Plant Discharge Permit, perform technical studies and achieve continued compliance with the recent Administrative Order from the U.S. Environmental Protection Agency. Recommended in the budget, therefore, are 4.5% increases in the Sewer Service and Use Charge Fund and the Storm Sewer Operating Fund.

A 4.3% increase is proposed for the Municipal Water System, to cover the increased cost of purchasing wholesale water from the Santa Clara Valley Water District and the San Francisco Public Utilities Commission. These costs have escalated significantly in recent years due to the need by these two agencies to fund major capital improvements to their systems and to meet more stringent water quality standards.

In the Integrated Waste Management Fund, expenditures increased 7.3% in 2005-2006. Additional increases are anticipated in future years due primarily to fuel and labor costs, landfill disposal costs, and the need to prepare for unknown future contract costs starting July 1, 2007. In 2005-2006,

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BUDGET OVERVIEW (CONT'D.)

Fee & Rate Increases (Cont'd.)

Council conceptually approved a 3-year plan of rate increases to cover these costs. Council approved an increase effective April 1, 2006, of 5% for single-family households and 3% for multi-family households for the first year of that plan. This Proposed Budget recommends implementation of year two of the plan, with increases of 5% for single-family households and 3% for multi-family households. Under the plan, a similar rate hike would be proposed for next year, but increased fuel costs and the potential of higher costs in a new hauler contract could require a greater increase.

Additionally, a 14.2% increase in Commercial hauler fees is proposed to ensure a higher level of cleaning activities on an interim basis in downtown while a long-term strategy for a “Clean and Green” downtown is prepared.

City Service Areas

The following section highlights the most significant proposals for each of the City’s six City Service Areas. A more detailed recitation of the proposals for each CSA can be found in the detailed budget pages following this message.

Community and Economic Development

Because the lack of a more robust growth in economically sensitive revenues continue to constrain the City’s operating budget, it is appropriate that the recommendations for the Community and Economic Development CSA continue to focus aggressively on implementation of the City’s Economic Development Strategy. These recommendations are in direct alignment with the priorities identified by the City Council:

- Attract and retain retail business to provide San José residents with more convenient services and help overcome San José’s high retail leakage to other communities with a particular emphasis on the automobile sector and the expansion of new and existing major retail centers;
- Communicate a compelling community identity to raise the image of San José in concert with and in support of our leading corporations and San José State University;
- Facilitate job and revenue generating company expansions and relocations and new housing development to provide the City with a competitive edge as a global economic center (e.g., the implementation of the North San José Development Policy);
- Encourage the development of cultural and sports events (e.g., ZeroOne Festival, Grand Prix, Tour of California, Rock and Roll Half Marathon) and the repositioning of existing events (e.g., Jazz Festival, Cinequest) to generate additional revenues, foster a dynamic quality of life and to enliven the City’s national and international image; and
- Expand efforts in museum/cultural growth, partnerships with San José State University, attraction and retention of businesses, and diversification of the economic base.

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BUDGET OVERVIEW (CONT'D.)

City Service Areas (Cont'd.)

Community and Economic Development (Cont'd.)

In this Proposed Budget, four positions added last year to the Office of Economic Development (OED) would be made permanent to address several Economic Development initiatives. They will assist in: 1) raising the image of San José as a destination; 2) attracting additional retail business; 3) increasing tourism money by encouraging sporting teams, events and facilities to locate in San José; and, 4) supporting development facilitation. Three of the positions are Economic Development Officers, one of whom will focus on communications. The fourth position is an additional Senior Events Coordinator in the Cultural Affairs division of OED to address increased special event activities such as community outreach, business involvement, traffic mitigation and multi-agency coordination.

In the area of events, it is proposed that the Sports Development Fund within OED be made permanent and funded at \$350,000 for 2006-2007 to support the initial phases of new events. OED will partner with the Sports Authority to provide resources to help attract Olympic and NCAA championship events when appropriate. No budget reductions are proposed for either the Sports Authority or the Arena Authority. A \$100,000 allocation is proposed to support the use of City facilities during the ZeroOne Festival (August 2006) which has received financial commitments from private and non-profit organizations in excess of \$1.8 million. No budget reductions from 2005-2006 levels are proposed for local small business chambers of commerce and the Convention and Visitors Bureau, enabling these organizations to engage in significant outreach and marketing activities to drive local economic activity.

The Silicon Valley Workforce Investment Network (SVWIN) program will shift to a greater reliance on permanent staff, significantly reducing the use of temporary unclassified employees. The program would continue to offer universal services to its clients through a reconfigured set of one-stop locations in Midtown and East San José, Morgan Hill and Gilroy. Not only will this new one-stop configuration result in more convenient and spacious locations, the substantial rent savings will be reinvested in client services.

In advancing this CSA's core service of building safe, healthy, attractive and vital communities, the Planning, Building, Public Works and Fire development services partners are focusing on restructuring service delivery to match the needs of specific customer groups, adding certainty to the development process, and improving the customer experience. Several investments are being proposed to achieve these goals and simultaneously respond to City Council direction through the Getting Families Back to Work and Counter-to-Council initiatives. To match staffing with activity levels and meet the needs of targeted customer groups, recommendations in the Proposed Budget would add two Fire Engineers, allow overtime funding for plan review, shift Public Works engineers to the fee program, and add two planners for the permit center. To add certainty to the development process, a Building engineer position would be added to coordinate with the inspectors. Improving customers' experience entails hiring a webmaster for the new Development Services Web portal and making physical improvements to the customer service areas in City Hall.

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BUDGET OVERVIEW (CONT'D.)

City Service Areas (Cont'd.)

Community and Economic Development (Cont'd.)

To achieve these goals we must maintain a strong fiscal foundation. To that end, a multi-year strategy to achieve cost recovery while softening the impact on customers is proposed. This includes a fee package that will enable the partners to cover the increased costs of current service levels and match staffing to activity levels. Other than an adjustment to Fire's hourly rate, there were no development fee increases in 2005-2006. This Proposed Budget recommends a 7% increase for Planning, Building and Public Works and 4.5% for the Fire Fee Program. This will cover rising costs in a number of areas: a 28% increase in retirement costs; a 16% increase in health care costs; the cost of modest, negotiated pay increases for staff; and cost component for office space in the New City Hall. The additional cost of new City Hall space is being phased in over five years for the development fee programs to mitigate the impact on the development community. City staff will continue to meet with development industry groups to ensure that their service delivery concerns remain a priority.

Several balancing strategies from prior years are reflected in this budget, including continued staffing reductions and redeployments that limit the Planning Services Division's ability to provide service within the Special Projects and SNI teams. Land use and planning actions to further the goals of the adopted SNI plans and specific plans will, however, be undertaken. Additional resources are proposed to partner with existing staff and begin the comprehensive update of the General Plan within this fiscal year as well as move forward with annexing unincorporated islands within the City. Both projects are projected to take about three years to complete.

Environmental and Utility Services

This CSA includes the San José/Santa Clara Water Pollution Control Plant, the Municipal Water System, South Bay Water Recycling, and Recycle Plus. Their primary value, lies in protecting the community's environmental resources, supporting its economic vitality, and providing essential public services such as garbage and recycling collection, wastewater collection and treatment, street sweeping, and storm water diversion. These large utilities also generate up to \$5 million annually in revenues for the General Fund through rate of return and in-lieu fees, plus approximately \$10 million annually in franchise fees from commercial solid waste activities and \$10 million in overhead payments.

Clean-up budget actions in 2005-2006 will result in the transfer back to four originating wastewater funds of approximately \$18 million of excess money that had accumulated in two San José Payment Funds for San José/Santa Clara Clean Water Financing Authority Bonds. In order to take advantage of lower interest rates in 2005, the Financing Authority refinanced its 1995 series bonds for South Bay Water Recycling. During the refinancing, the excess reserves were identified. In the first Payment Fund, the accumulated \$4 million in revenue has been used to pay off the bonds for which that Fund was established. Of the \$14.3 million excess revenue that accumulated in the second Payment Fund, \$12.5 million will be transferred back to the Sewer Service and Use Charge Fund and

2006–2007 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

City Service Areas (Cont'd.)

Environmental and Utility Services (Cont'd.)

will enable the City to reduce the magnitude of future projected increases in the sanitary sewer rate. The remainder is available for other uses as yet to be determined, including a portion that will be set aside in the source funds until the issue of any potential rebate liability with the IRS can be reviewed with the City's arbitrage consultant. After researching the history of the Funds, it was concluded that the excess reserves accumulated for the following reasons: 1) budgeted payments for the variable rate bonds were appropriated at 5%, while actual payments were less due to lower interest rates during this time; 2) as the City's debt was amortized, the level of reserve funds required to be on deposit at the bank declined and the bank then applied these liquidated reserve funds to the debt service invoices, lowering actual payments; and 3) lack of a formal review of actual cash reserve levels and annual budgeted appropriations in the Payment Funds. Going forward, a number of administrative controls will be implemented to prevent the excess accumulation of revenue in the remaining Payment Fund.

While the economic downturn has had relatively limited impact on revenues for this CSA compared to those supported by the General Fund, stricter regulatory requirements and an aging infrastructure continue to affect the cost of delivering these programs. Highlights of the proposals included in the Environmental & Utility Services CSA budget submitted for 2006-2007 follow.

With the City's utility infrastructure continuing to age, the need to invest in rehabilitation is growing. To address the storm sewer system, the CSA is proposing a third year of funding (\$500,000) to replace or rehabilitate aging storm pump stations, reducing the risk of localized flooding in portions of the City and a second year of funding (\$500,000) to complement the City's Strong Neighborhood Initiative by allocating dollars for neighborhood storm drainage improvements to reduce localized ponding. To address critical unfunded needs in the sanitary sewer system, the CSA is recommending the allocation of \$300,000 for a pilot project to install a hydrogen peroxide injection station along Zanker Road to address odor issues and \$600,000 to remove grease and sediment from the City's large-diameter interceptor system.

Over the next 10 to 15 years, it is estimated that up to \$250 million will be required to fund infrastructure rehabilitation and repair projects at the wastewater treatment plant. Examples include \$64 million for electrical reliability improvements; \$15 million in valve, pump and motor replacements; \$10 million in underground piping replacement; \$30 million in old headworks rehabilitation; \$21 million in digester replacements and improvements; and \$10 million for replacement of 30-year old blowers. These recommended investments are described in detail in the 2007-2011 Proposed Capital Improvement Program document released last week. Additional funding strategies for addressing these needs will be brought forward during subsequent budget cycles.

2006–2007 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

City Service Areas (Cont'd.)

Environmental and Utility Services (Cont'd.)

The services of a consultant are recommended to assist with a redesign of the Commercial Solid Waste Collection System in order to increase diversion from the landfill, enhance revenue collection capabilities, ensure a level playing field for competing haulers, and provide staff with administrative tools to address performance and service issues. This would also address Council's direction last March to develop a "Clean & Green Downtown" program using a City contractor to provide integrated garbage, recycling and cleaning services. Costs for this program are proposed to be passed through to commercial customers in an exclusive downtown district as a means of improving service delivery and cleanliness in the downtown area. However, since this downtown program may not be fully implemented until 2009-2010, annual funding of \$500,000 through City and other agency contributions is proposed to enable the departments of Transportation and Environmental Services to perform additional cleaning activities until the full downtown program is implemented.

An additional position is proposed to be added to meet requests from schools for technical assistance to increase diversion of recyclable waste, as required by SB 373. This supports the City Council's endorsement last March of the "Go Green" Program, which promotes school-based environmental stewardship through recycling, composting, environmental education, environmentally preferred procurement, and evaluation of impacts of environmentally responsible behaviors. To implement existing federal NPDES (National Pollutant Discharge Elimination System) permit requirements for stormwater discharge, and avoid more burdensome regulations in the future, approximately \$400,000 is recommended to provide a variety of activities and tools. Included would be operation and maintenance of treatment and storm flow control measures, installing devices to prevent trash from entering the storm sewer system and creeks, piloting Integrated Pest Management activities to minimize the use of pesticides, evaluating short- and long-term strategies for stormwater management, and providing additional staffing support to manage the stormwater programs.

Another recommendation would expand neighborhood parking enforcement on street sweeping days by posting signs on an additional 40 miles in targeted areas at a cost of \$240,000. This would be the fourth year of a multi-year strategy to keep neighborhood streets cleaner and prevent debris from polluting local creeks by enabling street sweepers to clean more thoroughly along curbs.

The City continues to address the requirements of the EPA Administrative Order (AO) issued in March 2005. Several additions are required to meet the mandates of the AO including: development and implementation of a training plan for Source Control, completion of an audit of the pretreatment and pollution prevention programs by an external auditor, and expansion of activities to monitor the sanitary sewer system. Additional resources are proposed to implement a Fat, Oils, and Grease (FOG) inspection program and to expand the Pollution Prevention Programs as required by the Regional Water Board.

2006-2007 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

City Service Areas (Cont'd.)

Environmental and Utility Services (Cont'd.)

The above proposals fund the highest priorities for the E&U CSA and sustain and/or advance compliance with various regulations that this CSA must uphold. In addition, the CSA's regional partnering will be even more critical across core services in the coming fiscal years, particularly in continuing to address issues related to land development, water supply availability, and watershed protection.

Neighborhood Services

The neighborhood focus of this CSA has been strengthened by last year's decisions to add the Housing Department and the Code Enforcement Division of Planning, Building and Code Enforcement. The Library Department and the Parks, Recreation and Neighborhood Services Department remain members of this CSA. As a reflection of these changes, the CSA has restated its mission as *"to serve, foster, and strengthen community by providing access to lifelong learning and opportunities to enjoy life, ensuring a diverse range of housing opportunities, and preserving healthy neighborhoods."*

As the second largest recipient of General Fund resources, the Neighborhood Services CSA has had to adjust to significant reductions over the past several years in order to generate savings and minimize impacts on other essential services. While some additional reductions are recommended this year, this CSA will actually experience a net increase in resources primarily to meet the ongoing operating and maintenance needs associated with bond-funded facilities that will be opening in 2006-2007.

Within this CSA the 2006-2007 Proposed Operating Budget recommends the addition of \$2.5 million and 50.7 positions across all funds. In the General Fund, a reserve fund earmarked for maintenance and operating costs of new facilities will be drawn down and \$3.3 million will be used to support 55 positions and other operating and maintenance costs associated with facilities opening in 2006-2007. This includes new and replaced branch libraries, new community centers, trail segments, parks (both new and expanded), as well as dog parks. For the first time in a number of years, the CSA will not have to stretch existing resources thinner in order to operate and maintain the new facilities or acreage. Resources are proposed to be added to allow the Library and PRNS to operate their new sites and facilities at the current levels of service.

The Library Department will offer fundamental and essential library services at much the same level as in 2005-2006. Although 4.6 vacant positions are proposed for elimination, there are no changes recommended to the current library hours. The previously mentioned reserve funds will provide operating and maintenance services for four new and expanded branch libraries that will be fully operational (Almaden, Evergreen, Cambrian, and Hillview).

A slight change in the scheduled grand opening of two new branches will allow for nominal staff and resource savings to be realized in the General Fund for 2006-2007. Nearly all 20 projects

2006–2007 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

City Service Areas (Cont'd.)

Neighborhood Services (Cont'd.)

funded from the 2000 Library Bond will be in design, under construction, or completed in 2006-2007. The 2006-2007 Proposed Operating Budget also provides ongoing funding for administrative support for the Smart Start and Early Care programs. In addition, a Literacy Program Specialist position is also recommended in the Early Care and Lifelong Unit. This previously grant-funded position would continue to provide support to the Family Learning Center and assist in implementing literacy initiatives.

The City currently operates 42 community, satellite, and neighborhood centers with a staff of 75. During the coming year two new community centers will open. Staff is moving forward with a Re-Use Plan to identify alternative programming options for some of these older facilities. Approximately half of our community centers are under consideration for alternative programming possibilities. Community-based organizations will be recruited through a competitive process in order to provide neighborhood and community services. In some cases, Parks Maintenance could work out of these facilities. Only if no suitable tenant can be found would centers be considered for closure. This proposed alternative programming is a source of savings proposed in this budget since some of the utility budgets to operate these sites are reduced with the expectation that the expense to the City will be reduced. In addition, non-personal/equipment funding for PRNS programs has been reduced across the board by less than 5% to realize savings of \$95,000 without major program impacts. Also, 4.63 FTE positions that have been vacant for at least one year are proposed for elimination; their prior duties having been absorbed by existing staff. These positions can be reduced to realize savings without having an impact on the current level of services being delivered.

In park maintenance, the maintenance capabilities for our parks will not be negatively impacted except for a change in the way maintenance activities are conducted at the San José History Park. As noted above, assets have been added to address maintenance and operations at new and improved park sites, but are only sufficient to maintain current service levels. Beginning in 2005-2006, the neighborhood park maintenance schedule was reduced by two days, while regional park maintenance dropped to six days per week. Two positions that manage the delivery of small capital projects in-house and are supported by the General Fund are proposed to be transferred to Capital Fund support. Team San José will be assuming responsibility for Convention Center grounds maintenance and the 1.5 City staff positions will be eliminated.

Therapeutic services, the Office on Aging and the Aquatics Program are not reduced in this budget and current service levels will be maintained. The Future Teacher Loan Program is proposed to be eliminated since interest in the loans has waned and the action realizes a \$100,000 savings annually without any significant impact. Other areas proposed for reduction include reduction of staffing in the Adult Sports Program, which will increase the cost-recovery level from 83% to 91%. Several fee increases in PRNS will generate \$56,000 in additional General Fund revenue.

2006–2007 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

City Service Areas (Cont'd.)

Neighborhood Services (Cont'd.)

The Strong Neighborhoods Initiative (SNI) is the core of the City's efforts to ascertain neighborhood priorities, deliver effective neighborhood services, and develop effective community leadership and partnerships with residents. In 2006-2007, there are no proposed staffing changes in the existing Strong Neighborhoods program. Since its inception through this fiscal year, 104 top ten priority capital projects have been completed and 48 more are underway. In response to the Mayor's Budget direction to expand the Strong Neighborhoods program to other areas of the City, \$5 million in one-time General Fund dollars has been reserved. In the coming fiscal year, staff will be working on an implementation plan to extend the SNI model of community building and service delivery to the wider City. This will require closer cooperation across all departments and particularly between the SNI program and the Neighborhood Development Center.

While no budgeted resources for the Neighborhood Development Center (NDC) are being cut in this proposed budget, a change in Community Development Block Grant funding instituted two years ago eliminates the ability of the City to continue funding four NDC positions previously funded through a CDBG grant. As part of the implementation plan for the new expanded Strong Neighborhoods program, the Administration expects to bring forward a proposal later in the budget process to sustain the services previously provided by these positions.

In the Proposed Budget, Code Enforcement will continue its commitment to respond to complaints that involve immediate threats to life and safety within 24-48 hours. In addition, in an effort to improve responsiveness to minor blight conditions – which negatively impact the “quality of life” in our neighborhoods – Code Enforcement has implemented an enhanced inspection program that will improve response times significantly. The addition of two fee-supported positions is recommended – one will be dedicated to Multiple Housing Program, the other will renew the Abandoned Shopping Cart Enforcement Program.

To better coordinate the administration of federal Housing and Community Development funds, the Community Development Block Grant Program, which has been part of PRNS, would be consolidated with other HUD programs in the Housing Department and overall staffing for CDBG administration would increase by one position, under recommendations in this budget. A Development Specialist position would also be added to support the growing loan portfolio compliance and servicing requirements. In this period of reduced funding for affordable housing, a focus on non-monetary activities will continue, including identifying new sites for housing development, strengthening the City's inclusionary housing program, implementing a new secondary unit pilot program, addressing concerns regarding illegal secondary units, revising Single-Room Occupancy requirements, lobbying for continued federal funding, supporting City Rent Control programs, and promoting fair and equitable lending.

Safe schools remain a high priority for the Neighborhood Services CSA and this Proposed Budget sustains existing service levels for the Safe Schools Campus Initiative response teams and the

2006–2007 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

City Service Areas (Cont'd.)

Neighborhood Services (Cont'd.)

operational services of our Youth Intervention Services (YIS) Programs. However, 3.26 positions (vacant for more than a year) in the anti-gang Striving Toward Achievement with New Direction (STAND) will be eliminated in order to create two positions to consolidate management and oversight of all of the YIS Programs. These additions will increase the efficiency, effectiveness and consistency of these programs and result in more complementary and coordinated services.

Though these are difficult economic times, the Neighborhood Services CSA continues creatively to rethink City service delivery, build on and create new partnerships, and connect with residents and stakeholders to identify neighborhood priorities.

Public Safety

Services in the Public Safety CSA remain among the City's highest priorities. In 2005-2006, the Public Safety CSA refocused on its "roots" to maintain essential services that enhance safety in our neighborhoods during day-to-day events, natural disasters, or terrorist threats. For 2006-2007, resources will continue to be focused on providing these essential emergency services in a timely manner.

Recommended in the 2006-2007 budget are the restoration of a permanent dedicated Hazardous Incident Team, currently funded on a one-time basis; and additional resources for new Fire Stations #33 and #35, slated to open in July 2007. A total of 35 positions will be added or restored to ensure adequate fire response in the Communications Hill area and South San José and to maintain the current level of dedicated hazardous materials response.

The recent transfer of wireless 9-1-1 calls from the Highway Patrol to local agencies has increased the number of calls handled by City staff and consequently the average answering times for 9-1-1 calls. The addition of six Public Safety Dispatcher positions would decrease the average answering time for 9-1-1 calls to levels experienced prior to the transfer of these calls (2004-2005 actual average was 3.97 seconds). The continuation of the Emergency Communication System Support Fee would be required in order to fund these positions and improve the dispatch service in the City. Police Department Operations Support Services Division has experienced significant backlogs entering and providing reports for the public and officers. A two-year task group would provide six additional Police Data Specialist positions in order to address this issue. Combined with the filling of current vacancies, this group is expected to reduce the backlogs experienced to more acceptable levels. Having reports available and up-to-date will help to ensure the safety of officers and improve customer service delivery.

Continuing with the focus of maintaining vital public safety services and consistent with the Mayor's March Budget Message, one Senior Analyst position would be added to expand "San José Prepared!" to new neighborhoods citywide. New abbreviated four-hour training courses, an update

2006–2007 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

City Service Areas (Cont'd.)

Public Safety (Cont'd.)

to the Office of Emergency Services website, and new strategies to optimize the effectiveness of existing training courses would be achieved as a result. The addition of a Police Website Coordinator would improve information delivery and customer service to the general public including crime prevention presentations and updated crime statistics. The addition of one Hazardous Materials Inspector, funded by Fire Fees, would ensure timely inspections of underground storage tanks and complex hazardous materials facilities required as part of new State-mandated regulations.

Several resource reductions are recommended to generate savings in the General Fund while maintaining this CSA's focus on vital emergency services delivery. The elimination of overtime for the Truancy Abatement-Burglary Suppression (TABS) Program will generate \$231,000 of savings in the General Fund. On-duty officers will continue to detain and transport truants to TABS centers if the officer is not on a higher priority call. In addition, participation of officers in attendance review board meetings will be limited. In total, the elimination of 9.38 vacant positions in the Police Department would generate \$641,000 in General Fund savings. A reduction in statistical support for crime analysis, reduced support for the Court Liaison Unit, and increased supervisory responsibility for remaining School Safety Coordinators, as currently realized by these vacancies, will occur on a permanent basis. Lastly, the elimination of one Fire Engineer Academy and the shifting of Fire Apparatus Replacement funding to the Capital Fund would generate \$1 million of General Fund savings with no service impact in 2006-2007.

While the above recommendations may include some minimal impact on services, it should be noted that with its 2006-2007 proposed funding level, the Public Safety CSA will:

- Continue to provide essential emergency services in a timely and effective fashion
- Continue to meet EMS paramedic contractual requirements
- Maintain investigation concentration on crimes against persons
- Maintain school liaison functions and protocols including SHARP & Safe Schools Initiative
- Continue to protect the health and safety of Public Safety personnel
- Move forward with Bond projects that do not adversely affect operating expenditures
- Continue to explore opportunities for public outreach and training to make residents more capable of maintaining their individual safety
- Effectively investigate arson fires and aggressively pursue, apprehend, and prosecute suspects in these incidents
- Continue to use grant funding to pursue inter-agency communications projects, in compliance with Department of Homeland Security directives
- Continue to put San José in the forefront of Homeland Defense in Northern California by continued active participation in the FBI's Terrorist Task Force and strong linkage with Homeland Defense

2006–2007 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

City Service Areas (Cont'd.)

Transportation and Aviation

The upcoming fiscal year marks the second for the Transportation and Aviation Services CSA which now has a consolidated service mission – to provide the community with safe, secure, and efficient surface and air transportation systems that support San José’s livability and economic vitality.

The CSA partners have undertaken several major coordinated initiatives, such as reconstruction of the Coleman Avenue/Interstate 880 interchange, reconstruction and landscape redesign, and implementation of a new taxi service model at Norman Y. Mineta San José International Airport and Citywide. Over the upcoming year, additional efforts will be undertaken in the following areas:

- Pursuing long-range regional transit connections;
- Implementing parking management and revenue control systems;
- Identifying additional in-sourcing opportunities;
- Continuing neighborhood livability strategies to mitigate transportation system impacts; and
- Enhancing communication infrastructure linkages between the Airport and the City’s Emergency Operations Center.

The CSA is undertaking this continuous effort to improve service delivery despite the resource limitations necessitated by our region’s prolonged economic downturn. Over the past few years, both surface and air transportation systems have suffered severe reductions in revenues needed for capital development and operations and maintenance. The upcoming year reflects continued strain on transportation revenues. Nonetheless, in keeping with City Council direction, this proposed budget avoids drastic cuts in transportation operations and maintenance.

Though new reductions are not as significant for the surface transportation system as in years past, the condition of the City’s system is in decline, and current funding is insufficient to adequately maintain, operate, and improve it. An estimated \$370 million would be needed for one-time transportation infrastructure rehabilitation and capital improvements, and an ongoing annual operating and maintenance shortfall is projected between \$18 and \$24 million over the next 5 years. In recognition of this disparity between needs and resources, a new one-time Reserve for Transportation Infrastructure Maintenance Backlog in the amount of \$5.3 million is proposed in the General Fund in 2006-2007. As noted earlier in this message, the reserve will begin to address the backlog in transportation infrastructure maintenance with improvements to include areas such as street maintenance, traffic signals, and streetlights. In addition, the sidewalk repair grant program will remain at the same level of funding which, based on historical use, should carry the program through eight months. Over the past five years, the City has spent approximately \$9 million on sidewalk repairs.

For the air transportation system, this proposed budget reflects the City’s commitment to support a scaled-back yet accelerated Airport Master Plan projected for completion in 2017. The most

2006–2007 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

City Service Areas (Cont'd.)

Transportation and Aviation (Cont'd.)

significant component of this \$1.5 billion plan is the Terminal Area Development Program, which includes improvements to Terminal A, construction of Terminal B, demolition of Terminal C, and various roadway projects and associated utility improvements. To support the revised capital program and ensure the new terminal, roadway, and parking facilities are designed and constructed for a positive, reliable, and efficient traveler experience, the Airport will add several new positions, including two temporary Terminal Development Managers, a Sign Shop Manager, a Governmental Affairs Manager, and the Air Service Development Manager through the elimination of 10 vacancies. This proposed staffing realignment will enable the Airport to restructure terminal area management duties, respond quickly to construction signage requirements, liaison with lobbyists and government staff and procure government funding, and assist with air service development.

Strategic Support

The Strategic Support CSA is made up of Employee Services, Retirement, Finance, Information Technology, General Services and Public Works. The CSA's outcomes are:

- A high performing workforce that is committed to exceeding customer expectations;
- Safe and functional public infrastructure, facilities, materials, and equipment;
- Effective use of state-of-the art technology; and,
- Sound fiscal management that facilitates meeting the needs of the community.

In the fifth consecutive year of reductions, the CSA is working diligently to prioritize and provide the most critical services in a quality manner. Though proposed reductions are less severe than in recent years, a number of staff positions are, nevertheless, proposed for elimination, making it increasingly difficult to provide core services at the desired level. For example, reductions in the employment function have lengthened the number of days that it takes to complete the recruitment process. Similarly, IT staff reductions have made it difficult to provide basic services to departments, while simultaneously managing new IT systems being brought on-line. Another recommendation would reduce one-time vehicle replacement funding. General fleet replacements have now been frozen for five years, and the average age of the fleet, which includes vehicles from sedans to heavy equipment, is ten years. The vehicle replacement fund would be reduced by \$750,000 leaving only \$1 million to address any purchasing needs during the coming fiscal year.

Concurrent with these and other ongoing reductions, the CSA is, however, proposed to receive several key additions to the budget to address Council priorities and achieve the outcomes stated above.

During the next five years, the City's existing workforce may be reduced by as much as one-third due to retirements. This presents both a challenge and an opportunity for "building the bench" and

2006–2007 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

City Service Areas (Cont'd.)

Strategic Support (Cont'd.)

to make further progress in diversifying the workforce, especially in the executive and senior management positions. In anticipation of this, one-time resources are proposed for consulting services (\$100,000), and an additional staff person (\$102,835 ongoing) will be devoted to managing this effort. A plan to address these concerns is under development and over the next fiscal year we will begin to implement specific initiatives.

The Departments of General Services and Public Works are charged with providing a safe and functional public infrastructure, which now includes City Hall. In addition to delivering quality capital projects such as City Hall, this responsibility includes managing operational and custodial services. As City Hall is newer, larger and more complex than any other City facility, it carries with it the expectations for a higher quality of maintenance. General Services was provided with additional funding for contract custodial services when the building opened, and a recommendation is included in this budget to bring daytime custodial services in-house by adding two positions and redeploying a third. In addition, through careful analysis, the CSA has identified opportunities to in-source electrical and fleet maintenance activities at substantial savings.

Consistent with the City's desire to effectively use state-of-the-art technology to improve customer service and create operational efficiencies, a one-time \$3.5 million reserve is recommended in this budget to address the most critical technology needs for the City. A listing of recommended projects to be funded is still under review, but it is clear that the amount of money in the reserve will not be sufficient to meet all of the current identified needs in this area. Specific proposals for the use of this reserve will be brought forward to the City Council for consideration at a later date.

Several other technology-related changes also are proposed that will improve access to data and streamline work processes. The City will be installing WiFi connectivity in the downtown zone and funding will support maintenance costs for this new system (\$60,000). For Public Works, funding is proposed (\$310,000) to design and develop a City-owned property database to enable review of property history and site characteristics prior to engaging in development plans. Secondly, funding is included (\$50,000) to improve the Public Works Inter- and Intranet sites to enable users to look up services and search for documents without staff assistance.

Information Technology is responsible for managing the Voice Over Internet Protocol (VoIP) system installed in the New City Hall. The CSA is proposing funds (\$610,000) to continue Nortel's managed services for an additional year while IT staff complete the required training to fully take over maintenance and operation of the system from Nortel.

The CSA has been working for several years, along with the Environment and Utility Services CSA, to develop a new Consolidated Utility Billing System (C-UBS). C-UBS, which is scheduled to "go live" at the end of June, is a comprehensive system that will for the first-time provide a one stop customer service and consolidated utility billing interface. Legacy municipal water, RecyclePlus, and

2006–2007 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

City Service Areas (Cont'd.)

Strategic Support (Cont'd.)

storm and sanitary sewer billing systems will be replaced. There will be a consolidated utility bill for RecyclePlus and Municipal Water customers, Internet self service, a direct interface to hauler field activity systems, and management portals with enhanced reporting for partner performance monitoring. In addition, the program consolidates the City's Utility and Customer Service call centers. Because IT, Finance, and Environmental Services will be involved in stabilization efforts following the launch, the CSA is proposing additional funding for staff dedicated to this effort during the first quarter of 2006-2007, and the addition of one permanent IT staff member to ensure full-scale operation of the new system.

Three other proposals will strengthen the City's fiscal management. Funding is proposed (\$343,000) to initiate a phased plan to centralize the procurement process and enable Purchasing to provide oversight and assistance with the addition of two Senior Analyst positions. This will ensure efficient, consistent, fair, and transparent RFP/RFQ processes for procuring professional services. In the Finance Department's Investment Section, the addition of a Financial Analyst is recommended to strengthen oversight of the City's \$2 billion investment portfolio. Finally, an internal Grants Management Team would be formed using existing resources and led by a City Manager's staff person with an additional staff person from Housing and from PRNS. In response to audit recommendations and the Mayor's Message, this team will strengthen oversight of grants provided by the City.

Finally, a proposal to recover fees paid to collection agencies would levy a \$25 or 15% fee, whichever is higher, on delinquent accounts in the General Fund. This would generate at least \$200,000 annually.

Capital Improvements — Investing in the City's Infrastructure

The 2006-2007 Proposed Capital Budget is substantial, accounting for approximately one-third of the City's total proposed budget. Now in the second half of the *Decade of Investment*, the city's Capital Improvement Program continues to transform San José's public infrastructure. While these projects, such as roadway improvements, enhanced recreational and park facilities, new libraries, and improved public safety facilities enhance the quality of life for our residents, operating the new facilities continues to challenge the organization during tight fiscal times.

Capital investments proposed over the next five years are significant with a 2006-2007 Proposed Capital Budget of \$1.07 billion and a 2007-2011 Proposed Capital Improvement Program (CIP) of \$2.57 billion. This is a marked difference from years prior to 2000 when annual capital budgets were approximately one-quarter to one-half of the amounts budgeted in recent years. In large part, the significant growth in the capital program results from the use of one-time funding sources that support particular efforts. For instance, voter-approved bond revenues are earmarked for parks, library or public safety purposes; the new City Hall was funded by lease revenue bonds limited to

2006–2007 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

Capital Improvements — Investing in the City's Infrastructure (Cont'd.)

that project; and the Airport expansion is primarily funded by the issuance of debt that will be supported by Airport revenues.

More than 900 projects have already been completed during the first half of the *Decade of Investment*. During 2006-2007, we expect to add more than 150 additional projects to that list, including two newly renovated libraries, two new fire stations, numerous park and trail improvements, fire station upgrades, several new traffic signals, and utility infrastructure improvements. Many other projects that support the City's economic development goals are also underway. These include the Airport expansion, major roadway and traffic flow improvements, expansion of the Sanitary Sewer System into Edenvale, and capacity improvements to the Municipal Water System.

Major Capital Investment Highlights

Mineta San José International Airport — In November 2005, City Council approved a revised Airport Master Plan. The major revisions include extending the Master Plan completion to 2017 and limiting the cost to \$1.2-\$1.5 billion. This plan will allow facility and customer service improvements to proceed in a more economically viable manner and, at the same time, deliver some of these improvements sooner than planned.

Parks, Libraries, and Public Safety Facilities — In 2000 and 2002, voters approved General Obligation Bond measures to support library projects (\$212 million), parks projects (\$228 million), and public safety facilities (\$159 million). In 2006-2007 alone, the City will complete construction on two new fire stations and renovation of two libraries and one park. The City expects to complete all of the remaining bond projects in the next five years and the Proposed CIP released in April allocates a combined \$344 million in Bond funds for these purposes.

Utility Infrastructure — Significant investments in the City's utility infrastructure are ongoing, including the expansion of the water and sanitary sewer systems. The \$89 million Reliability Improvements project at the Water Pollution Control Plant is scheduled for completion in 2007-2008 and will be followed by Electrical Reliability improvements planned to begin in 2008-2009.

Identifying General Fund Resources to Address Operating Costs

As we noted last year, the large number of new and expanded facilities that are opening as a result of the *Decade of Investment* bring with them substantial operation and maintenance costs. The 2006-2007 Proposed Operating Budget includes funding of \$3.7 million to operate the parks and library facilities that are scheduled to become operational next year.

In the last few years, several strategies were implemented to defer or reduce operating and maintenance costs including the deferral of completion dates for capital projects. Given the extent of the actions already taken and the competing trend of rising construction costs, the Proposed CIP recommends no significant additional project deferrals. Rather, the focus will be to deliver on

2006–2007 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

Capital Improvements — Investing in the City's Infrastructure (Cont'd.)

commitments to the public by completing the projects approved by voters, and the operating and maintenance costs associated with those projects are included in our five-year forecasts. In addition, staff will continue to pursue measures designed to reduce operating and maintenance costs. These include installing the most cost-effective traffic signals, funding for parks capital maintenance projects, and maximizing economies of scale through joint interdepartmental facilities.

CONCLUSION

This 2006–2007 Proposed Operating Budget successfully closes a \$34.9 million dollar shortfall with a combination of some ongoing reductions, the strategic use of reserves and one-time dollars, the proposed extension of the ECSS Fee, and with fee increases designed to continue moving the City closer to full cost recovery in a number of areas. In addition, the coordinated efforts of every City Service Area identified opportunities to be more efficient while reducing costs. We believe the mix of solutions represents a sound approach to balancing the budget. Unlike past years, we have been able to minimize the use of one-time solutions with the added benefit that this reduces future year shortfalls. We have minimized the number of positions to be eliminated and selectively added positions to meet critical needs. In addition, for the first time in more than five years we have been able to set aside significant dollars to begin addressing a substantial backlog of unmet infrastructure maintenance needs that have grown significantly over the past few years. We have maintained our commitment to provide essential services and to keep the City Council's commitment to neighborhoods. While it is clear that we are in a “delicate” economic environment (with high office vacancies, continued weak job growth, and rising fuel costs), we are nonetheless showing signs of now emerging from the prolonged economic downturn. This plan maintains the sound financial discipline that has allowed us to manage through the long recession.

I have been very impressed with the strong commitment and high degree of professionalism that I have found in the workforce since my return to San José. I want to express my appreciation to all of the dedicated City employees who have worked closely with the Administration as we moved through this budget process. In particular, I want to acknowledge and express my sincere appreciation to the many employees at all levels of the organization, but most especially to the hard working administrative staff in City departments as well as the entire Budget Office, who contributed to the preparation and production of this budget document.



Les White
City Manager